

MCLE ON THE WEB (\$15 PER CREDIT HOUR)

TEST #8

1 HOUR CREDIT

LEGAL ETHICS (Part 1)

To earn 1 hour of MCLE credit in the special category Legal Ethics, read the substantive material, then download the test, answer the questions and follow the directions to submit for credit.

Ethics and Your Clients

California Joan and the Temple of Loyalty: Watch out for pitfalls when both parties are your clients

By Ellen Peck

Professor Ethics was always pleased to receive a telephone call from one of his favorite former law students, now attorney, California Joan.

"Professor, help! I thought this was going to be the best day of my life. The general counsel of Cash Corp. called me today, wondering if my firm and I would be interested in handling all of Cash's current commercial litigation. Cash faxed over a list of current litigation for conflicts checking.

"The biggest case on the list involves defending Cash in a trade secrets case brought by New Software Partners (NSP). Just my luck, NSP is a current client of the firm on a few lease matters in our real estate department. Professor, our work for NSP is completely unrelated to this big case, and I can't find any rule of professional conduct which prohibits us from taking the case against our current client."

Professor Ethics exclaimed: "Well, Cali, you're right. Current rule 3-310(E) prohibits your acceptance of representation of a client if it involves use of material confidential information related to the representation of a current client. However, there is currently no California rule of professional conduct prohibiting taking an adverse action on behalf of a new client against a current client in a completely unrelated matter.

"Until 1992, there were general conflicts rules which California courts had interpreted to prohibit taking adverse actions against current clients in unrelated matters. In 1992, when the primary conflicts rule (3-310) was substantially redrafted, the part of the rule which would have codified the past prohibitions of acting adversely to a client in an unrelated matter were inadvertently omitted from the rule. In the past few years, the State Bar has studied whether a new rule should be adopted, but its study terminated in part due to lack of agreement on scope, structure and wording of such a rule and in part because of the State Bar's current funding crisis."

Sighed a relieved California Joan, mentally calculating her year-end bonus, "So, if the rules of professional conduct do not prohibit it, I can take the case!"

"Wrong," thundered Professor Ethics. "Just because a lawyer may not be prosecuted or found culpable for an attorney disciplinary offense under the Rules of Professional Conduct does not mean that they do not have other professional responsibilities under law. Let me take you through it.

"Remember, Cali, the attorney-client relationship is a fiduciary relation of the very highest character. (Neel v. Magana, Olney, Levy, Cathcart & Gelfand (1971) 6 Cal.3d 176, 189-190; Clancy v. State Bar (1969) 71 Cal.2d 140, 146-148.) The fiduciary relationship requires an attorney to have undivided loyalty in protecting the client's interests.

"The first case to discuss the application of the duty of loyalty to suing a current client was Jeffrey v. Pounds (1977) 67 Cal.App.3d 6. Jeffrey arose in an action for attorney's fees by a lawyer who had represented Mr. Pounds in a personal injury action following an automobile accident. While the personal injury case was pending, Mrs. Pounds (wife of Mr. Pounds) hired another partner in the same firm to prepare papers necessary for her divorce from Mr. Pounds. When Mr. Pounds learned of the firm's representation of Mrs. Pounds, he obtained a new counsel for the personal injury action which thereafter settled. Mr. Pounds claimed that his prior attorney's claim for quantum meruit fees out of Mr. Pounds' personal injury settlement should be barred for accepting employment hostile to the client's interests. (Jeffrey, supra, pp. 8-9.)

"The court of appeal agreed and denied any compensation after the attorney's firm accepted employment by Mrs. Pounds against Mr. Pounds, the current client in an unrelated matter. The court of appeal held that it is a violation of an attorney's duty to undertake the representation of a third person suing an existing client in an unrelated matter without the client's knowledge and consent because such action breaches the lawyer's loyalty to the client and former rule 5-102(B), Rules of Professional Conduct. (Jeffrey, supra, at pp. 10-11.)"

"Well, P.E.," a nickname which Cali often used to refer to Professor Ethics, "if we can't defend Cash from our client NSP's case, can we at least recommend another good litigation firm that won't steal Cash from us in other litigation matters?"

"I don't think so," Professor Ethics responded, dashing Cali's remaining hopes for salvaging the situation. "The California Supreme Court has recently addressed that exact question in Flatt v. Superior Court (1994) 9 Cal.4th 275 [36 Cal.Rptr., 885 P.2d 950].

"Flatt arose as a malpractice action against a law firm for failing to advise a prospective client of the statute of limitations for a legal malpractice action in declining the engagement. The law firm's affirmative defense was that it had accepted Mr. Daniels as a client of the firm to file a legal malpractice action against Mr. Hinkle without realizing that Mr. Hinkle was an existing client in an unrelated action.

"The law firm believed that the fundamental duty of loyalty to its current client, Mr. Hinkle, required the firm to refrain from giving Mr. Daniels any advice about the merits of a potential malpractice action against Mr. Hinkle and that it had a duty to terminate Mr. Daniels as a client. The duty not to take any action hostile to Mr. Hinkle meant that the law firm could not advise Mr. Daniels of the statute of limitations for bringing a legal malpractice against Mr. Hinkle because it would be giving assistance to Mr. Daniels against Mr. Hinkle. The Supreme Court agreed, based upon the duty of loyalty owed to Mr. Daniels. (Flatt, supra, pp. 288-289)

"Although the conduct in the Flatt, supra, occurred prior to September 1992 and thus was covered by a former rule, the California Supreme Court majority opinion observed that the Rules of Professional Conduct after September 1992 contained no express prohibition of the conduct discussed. Rather than grounding its holding upon the former rule applicable at the time, its ruling was based upon the common law fiduciary duty of loyalty.

"So, Cali," P.E. went on soothingly, "save you and your firm from the potential charges of breach of fiduciary duty, non-payment of fees or disqualification by not taking any Cash case against any current client and do not give any other advice, such as making recommendations as

to counsel or when statutes of limitations might run, unless the current clients consent in writing to the adverse representation after full written disclosure."

The next morning, Cali's recommendation to litigation department partners that the firm decline the NSP v. Cash case was met with further brainstorming. Senior partner Meryl Terpitute posed an interesting solution:

"Look, NSP is not a real lucrative client. Let's terminate representation of NSP, making them a former client and then agree to defend Cash from NSP in the trade secrets case. Since we will not have acquired any secrets relating to the trade secrets case from NSP, we can't be disqualified and we will not have breached our duty of loyalty to NSP because NSP will no longer be one of our clients."

"That won't work either, Meryl," interjected Cali. "Truck Ins. Exchange v. Fireman's Fund Ins. Co. (1992) 6 Cal.App.4th 1050, the "hot potato" case, held that a lawyer or law firm could not avoid the "automatic" disqualification rule by firing the current client (converting them to a former client) in order to take on a new, perhaps more lucrative client, to sue the former client. In a subrogation action by several insureds and the insurers against another carrier, a law firm representing plaintiff insurer A sought to avoid disqualification by withdrawing from concurrent representation of a subsidiary of defendant insurer B in unrelated litigation. The court of appeal held that the duty of loyalty precluded the law firm from dumping a current client to obtain more lucrative employment from another client adverse to the current client."

"If we can't drop current clients to get better ones, this one has got to be acceptable," challenged Meryl. "I am currently representing Metrobank against Peach Computers in a breach of contract action relating to computer equipment. Peach thinks that I'm doing such a good job against them, they want to hire me to handle all of their real estate litigation. This litigation is completely unrelated to anything I'm handling for Metrobank and Metrobank is not a party or potential party to any of the real estate litigation. Surely, this is not a problem."

"It is a problem," retorted Cali. "Accepting representation from a party in a second action that is a current adversary of a current client in the first action, without written disclosure and written consent of the first client, would be a violation of rule 3-310(C)(3)." The litigation partners groaned but agreed that it would not accept any litigation that would affect its loyalty to its current clients.

A week later, Meryl Terpitute discussed other prospective representation with Cali, now considered the firm's expert on the duty of loyalty and acceptance of new business.

"In the first case, Cash is being sued by Airplane Owner for failure to bring the aircraft up to FAA specifications. Our current client, Metrobank, is not even a party to the action, but they do have a beneficial interest in the aircraft which is the subject of the litigation. Surely, since Metrobank is not even a party, we will not be violating the duty of loyalty by representing Cash against Airplane Owner," inquired Meryl hopefully.

"Well, Meryl, California published cases have not stretched the duty of loyalty that far. But we'd be taking a risk since a federal court in California, applying California law, recently disqualified a California firm in exactly that situation. GATX/Airlog Co. v. Evergreen International Airlines Inc. (1998 N.D. Cal.) 8 F. Supp.2d 1182 held that a lawyer may be disqualified if a current client in unrelated matter had potential claims against the lawyer's second client."

"In GATX, Evergreen Airlines contracted with GATX to convert certain aircraft for airworthiness consistent with FAA regulations. When the airplanes were later declared not airworthy for the necessary payload to make them profitable, the airlines made a claim against

GATX, prompting GATX to retain a law firm. GATX knew that Bank was a beneficial owner of one of the planes in the possession of Evergreen. During the almost three years of representing GATX, the law firm concurrently represented Bank in a number of unrelated matters and failed to obtain any consent to continued representation of GATX. Bank, which was not a party, was permitted to intervene in the litigation and disqualify the law firm from representing GATX against Evergreen.

"The district court judge grounded his decision on rule 3-310(C)(3), California Rules of Professional Conduct, holding that the law firm breached its duty of loyalty because (1) Bank had claims against GATX that might or might not become the subject of a lawsuit between GATX and the Bank; (2) the law firm advanced assertions in pleadings and dispositive motions that could provide GATX with defenses to claims by the Bank and other aircraft owners; and (3) the law firm asserted defenses against Evergreen's claims about the Bank's aircraft while in Evergreen's possession.

"Mr. Terpitute, I know that the GATX case has problems. First, the court misapplied rule 3-310(C)(3) to the facts, since GATX was not an adversary in any of the other matters in which the law firm represented the Bank. Second, even if the GATX case is considered an extension of the common law established by Flatt, I am not certain that California courts will adopt its holding. Even if GATX is narrowly construed to its limited facts, it applies to your case because Metrobank has a potential claim if litigation arises in which we propose to take an adverse position at a time when we concurrently represent Metrobank in other matters. It is too close to take a risk."

Meryl howled. "This is my last chance to bring in new litigation this year. We currently represent XYZ Inc., a wholly owned but completely independent subsidiary of Global Inc. in litigation against Joe Doaks concerning wrongful termination. Metrobank just asked me to bring an action against Global for patent infringement on its financial products. I suppose that just because we represent XYZ Inc., Global's subsidiary, that I owe Global a duty of loyalty not to sue it."

"No, Mr. Terpitute," offered Cali, "a recent California case has held that the duty of loyalty to an independent subsidiary does not extend to the parent corporation. In Brooklyn Navy Yard Cogeneration Partners, L.P. v. Superior Court (The Parsons Corp.) (1997) 60 Cal.App.4th 248, the court determined that the representation of a subsidiary did not necessarily create ethical duties to its parent corporation, precluding representation of adverse interests against the parent. The court adopted the analysis of the State Bar of California's ethics committee in Formal Opinion No. 1989-113 in holding that under rule 3-600, a parent corporation is not a client for conflict purposes just because a subsidiary is and the attorney's duty of loyalty to the subsidiary does not preclude a representation that is adverse to the parent where the parent is not the alter ego of the subsidiary."

Meryl breathed a sigh of relief after explaining to Cali that XYZ was legally, financially and in all other ways independent of Global and obtaining her agreement that she would recommend that the firm undertake the representation against Global.

Ellen R. Peck, a former trial judge of the State Bar Court, now practicing law in Malibu, is a member of the State Bar Committee on Professional Responsibility & Conduct, chair of the Los Angeles County Bar Association's Professional Responsibility & Ethics Committee and co-author of Vapnek, Tuft, Peck & Weiner (1997) "The Rutter Group California Practice Guide -

Professional Responsibility" and Lewis & Peck (1998) "Lawyer's Handbook on Fees and Fee Agreements."

Test — Legal Ethics

1 Hour MCLE Credit

This test will earn 1 hour of MCLE credit in Legal Ethics.

1. True/False. A lawyer cannot accept representation adverse to a current client if the new representation will call upon the lawyer to use confidential information of the current client.
2. True/False. If there is no rule of professional conduct prohibiting a lawyer from accepting representation, a lawyer breaches no duty by accepting such representation.
3. True/False. A lawyer's duty of loyalty prohibits a lawyer from accepting representation from a new client to sue a current client in an unrelated matter.
4. True/False. Courts may deny a law firm compensation for legal services provided to a client from the date that the law firm accepted employment hostile to the current client in an unrelated matter.
5. True/False. A law firm that represents client H in a personal injury action may represent client W against H in a dissolution matter, completely unrelated, provided that H receives a full disclosure of the consequences and consents in writing to the adverse representation.
6. True/False. A lawyer or law firm which terminates representation of client X in order not to take an adverse action against pre-existing client A nevertheless has to advise the terminated client, X, of the statute of limitations relevant to X's matter.
7. True/False. A lawyer or law firm which terminates representation of client X in order not to take an adverse action against pre-existing client B nevertheless has to refer terminated client X to competent counsel.
8. True/False. A lawyer who represents client A in a breach of contract action may nevertheless advise new client B concerning whether B has probable cause to initiate a professional liability action against A, so long as the pre-litigation advice is completely unrelated to A's breach of contract action.
9. True/False. A lawyer may terminate the representation of client X in order to thereafter accept representation of a more lucrative client Z against X in an unrelated matter.
10. True/False. After current client A's matter has terminated, a law firm may accept representation of new client B against A in an unrelated matter.
11. True/False. A lawyer that drops client A in an unrelated matter to accept representation of client B against A may be disqualified from representation of client B.

12. True/False. If a lawyer represents client A against client B in litigation, a lawyer may accept concurrent representation of client B in an unrelated litigation matter.
13. True/False. If a lawyer represents client A against client B in litigation, a lawyer may accept concurrent representation of client B in an unrelated litigation matter so long as the lawyer discloses the representation to client A.
14. True/False. If a lawyer represents client A against client B in litigation, a lawyer may accept concurrent representation of client B in an unrelated litigation matter so long as the client orally consents to lawyer's representation of client B.
15. True/False. In California federal courts, in litigation between party A v. party X, a lawyer may be disqualified from representing party A by a current client B even though B is not a party and is represented by lawyer in unrelated matters, if (1) client B had claims against party A that might or might not become the subject of a lawsuit between B and A which are also the subject matter of the litigation; (2) the law firm advances assertions in pleadings and dispositive motions that could provide party A with defenses to potential claims by client B; and (3) the law firm asserts defenses against party X's claims where client B has beneficial interest in the property which is the subject of the litigation in X's possession.
16. True/False. In California state courts, in litigation between party A v. party X, a lawyer may be disqualified from representing party A by a current client B even though B is not a party and is represented by lawyer in unrelated matters, if (1) client B had claims against party A that might or might not become the subject of a lawsuit between B and A which are also the subject matter of the litigation; (2) the law firm advances assertions in pleadings and dispositive motions that could provide party A with defenses to potential claims by client B; and (3) the law firm asserts defenses against party X's claims where client B has beneficial interest in the property which is the subject of the litigation in X's possession.
17. True/False. A lawyer that represents an independent subsidiary of a parent corporation also represents the parent corporation.
18. True/False. A lawyer that represents an independent subsidiary of a parent corporation owes a duty of loyalty to the parent corporation.
19. True/False. For the purpose of conflicts of interest, a parent corporation may prove that it is the alter ego of its subsidiary corporation and disqualify a law firm from representing an adversary if the law firm represents the subsidiary in an unrelated matter.

20. True/False. Where a law firm represents an independent subsidiary in one or more unrelated matters, and concurrently sues the parent corporation on behalf of a third party, the law firm will not be disqualified for a breach of the duty of loyalty to the parent corporation or the subsidiary, in the absence of the parent's showing that it was the alter ego of the subsidiary.

Certification

- This activity has been approved for Minimum Continuing Legal Education credit by the State Bar of California in the amount of 1 hour, of which one hour will apply to legal ethics.
- The State Bar of California certifies that this activity conforms to the standards for approved education activities prescribed by the rules and regulations of the State Bar of California governing minimum continuing legal education.

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TEST #8

1 HOUR CREDIT

LEGAL ETHICS (Part 1)

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|--------------------------|--------------------------|
| 1. TRUE ____ FALSE ____ | 11. TRUE ____ FALSE ____ |
| 2. TRUE ____ FALSE ____ | 12. TRUE ____ FALSE ____ |
| 3. TRUE ____ FALSE ____ | 13. TRUE ____ FALSE ____ |
| 4. TRUE ____ FALSE ____ | 14. TRUE ____ FALSE ____ |
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| 7. TRUE ____ FALSE ____ | 17. TRUE ____ FALSE ____ |
| 8. TRUE ____ FALSE ____ | 18. TRUE ____ FALSE ____ |
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| 10. TRUE ____ FALSE ____ | 20. TRUE ____ FALSE ____ |